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No. 774

In the Supreme Court of the United States

OCTOBER TERM, 1935

CORINNE S. KOSHLAND, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 25–32) is not reported. The opinion of the Circuit Court of Appeals for the Ninth Circuit (R. 108–133) is reported in 81 F. (2d) 641.

JURISDICTION

The judgment of the Circuit Court of Appeals reversing the Board of Tax Appeals was entered January 20, 1936. (R. 134.) Petition for writ of

certiorari was filed February 25, 1936, and was granted March 30, 1936. (R. 137.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether common stock distributed by a corporation to the petitioner as a dividend upon preferred stock is a nontaxable dividend, so that the original cost of the preferred stock is reduced by apportioning such cost between the preferred and common shares for the purpose of determining the gain upon the petitioner's subsequent disposition of the preferred shares, or a property dividend subject to taxation.

2. Whether the petitioner, having failed to report common stock received as a dividend upon preferred stock as a property dividend for income tax purposes in the years of receipt, is estopped to assert in a later year that such was a taxable dividend with no effect upon the cost of such preferred stock.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 39–42.

STATEMENT

The essential facts as stipulated (R. 59) and found by the Board of Tax Appeals (R. 25–29) are as follows:

The petitioner, a resident of San Francisco, California (R. 25), was a stockholder in the Columbia Steel Corporation (R. 26, 27), a Delaware corporation organized in November, 1922, with authorized capitalization of 100,000 shares of preferred stock of a par value of $100 per share, and 1,000,000 shares of common stock, originally of $10 par value each but by charter amendment of no par value (R. 25, 59, 61, 63).

At the time of its organization the corporation acquired from W. E. Creed certain property in exchange for 39,918.42 shares of its preferred stock and 547,500 shares of its common stock, to be issued to W. E. Creed or his nominees. (R. 25, 44, 45, 97–99.) The remaining preferred stock of the corporation was offered to the public at par (R. 26, 100), and Creed offered to certain prospective purchasers of the preferred stock five shares of his common stock for each share of preferred purchased from the corporation (R. 26). No common stock was sold by the corporation. (R. 45.) Petitioner, under this offer, subscribed for 150 shares of preferred stock at par, and in 1924 paid therefor $15,000 (R. 42, 43–44), with the understanding that she also would receive 750 shares of common stock (R. 26, 45). The 750 shares of common stock were issued to the petitioner as agreed. (R. 26.)

Dividends on the preferred stock were payable at 7 percent a year or, during the first five years of operation and in the discretion of the directors, in common stock at the rate of one share of common stock for each share of preferred. (R. 26, 89.) Dividends upon preferred stock, payable in common stock at the prescribed rate, were declared for the years 1925, 1926, and 1927 (R. 26), and in 1928 a dividend at the rate of one-half share of common stock and $3.50 in cash for each share of preferred was declared (R. 81–82). In each of these years the surplus of the corporation was in excess of a 7-per cent dividend on the preferred stock and, upon issuance each year of the common stock as a dividend, it was charged to surplus at the rate of $7 a share and credited to the common stock account. (R. 26.)

In January 1926 the corporation offered its stockholders of record the right to subscribe for a specified number of preferred and common stock in units of one share of preferred and 50 shares of common stock at $300 a unit. (R. 26–27, 54, 56, 71.) Petitioners exercised this right and purchased from the corporation 15 units, consisting of 15 shares of preferred stock and 750 shares of common stock. (R. 27.)

The petitioner, as the owner of preferred stock of the corporation, received shares of common stock as dividends on her preferred stock as follows (R. 27, 59):

January, 1925	127 shares common stock
January, 1926	150 shares common stock
January, 1927	165 shares common stock
January, 1928	82½ shares common stock

No amount was reported by the petitioner in those years as income representing the dividends received by her in common stock of the corporation. (R. 59.)

In 1930 the 165 shares of preferred stock then owned by the petitioner were redeemed by the corporation and the petitioner received therefor $17,325. (R. 27.)

The Commissioner determined that the prices paid by the petitioner upon her respective purchases of the corporation's stock in 1924 [1] and 1926 were for preferred and common stock together as a block or unit, and accordingly allocated the cost on each purchase to the respective classes of stock according to their values. The Commissioner further determined that the dividends paid in common stock in 1925 to 1928, inclusive, were nontaxable stock dividends, and accordingly the cost of the petitioner's preferred stock in respect of which the dividends were paid was apportioned to the two classes of stock on the basis of their respective values at the time the dividends were received. Thus the cost basis of the petitioner's preferred stock held and redeemed in 1930 was fixed for determination of the gain realized on the redemption

[1] The Board so found as to 1924. (R. 29.)

of such stock. The Commissioner therefore determined a deficiency in the petitioner's income tax for 1930 of $833.48 (R. 13, 20), of which there is $330.98 in dispute here.

The Board of Tax Appeals held that the common stock received by the petitioner during 1925 to 1928, inclusive, as a dividend on her preferred stock was not a nontaxable stock dividend and reversed the action of the Commissioner in making an adjustment of the petitioner's cost basis on that theory. The Circuit Court of Appeals reversed the decision of the Board.

SUMMARY OF ARGUMENT

If the dividends on preferred stock paid to the petitioner in common stock were nontaxable at the time of distribution under Section 115(f) of the Revenue Act of 1928 and Section 201(f) of the Revenue Act of 1926, the Commissioner properly spread the petitioner's cost over both the preferred and common stock in proportion to their respective values, and correctly computed the petitioner's taxable gain on the redemption of her preferred stock in 1930. The real question is whether the several distributions of common stock to the petitioner were nontaxable at the time when made. This is a question of statutory construction of the words "A stock dividend shall not be subject to tax", and there is no necessity to determine whether the distribution was constitutionally immune from tax.

The general meaning of the phrase "stock dividend" connotes any dividend paid by a corporation by a distribution of its new or theretofore unissued stock, and there is no occasion to limit the meaning of the phrase to such stock dividends as may be exempt from taxation for constitutional reasons. If, however, there can be said to be any doubt as to the meaning of the words "stock dividend", the doubt should be resolved in favor of the Commissioner's position by the administrative interpretation of the statute and the fact that the statute has been reenacted without change since it first appeared in the Revenue Act of 1921.

Since the stock dividends here in issue were nontaxable under the statute when received the Commissioner properly apportioned cost under valid regulations. The fact that Section 115 (a) (f) of the Revenue Act of 1928 did not expressly authorize the Commissioner to apportion cost in the case of a stock dividend is not decisive here since the Revenue Act in broad terms authorizes the Commissioner to promulgate rules and regulations needful for the enforcement of the Act. The regulation apportioning cost in a case of this type was needful for the purposes of the Act, consistent therewith, violated no provision of the Act, and has been approved by Congress.

If it be considered that the distributions here involved were not true stock dividends and hence were taxable, the petitioner should now be estopped to assert the fact and to deny that the Commissioner properly treated them as nontaxable stock

dividends and apportioned the petitioner's cost to the two classes of stock. During the years in which the common stock was received by the petitioner as dividends on her preferred stock, the petitioner reported in her tax returns no amount as income on account thereof. The statute provides that all dividends other than stock dividends constitute taxable income and requires that the taxpayer report such dividends in the return for the year in which they are received. In not reporting any of the dividends here in question as taxable dividends, the petitioner represented that they were stock dividends and were not taxable. The Commissioner accepted the petitioner's tax returns for the respective years as made by her, at least in this respect, and determined her tax liability on that basis. The petitioner should not now be heard to say that the distributions to her were taxable to her as dividends in the years of their receipt and were not as she then regarded them—stock dividends and nontaxable.

ARGUMENT

I

THE COMMON STOCK RECEIVED BY PETITIONER AS DIVIDENDS ON PREFERRED STOCK WERE NONTAXABLE STOCK DIVIDENDS

The principal question presented here is whether the distributions of common stock in this case are embraced within the terms of Section 115 (f) of the Revenue Act of 1928, *infra*, and Section 201 (f) of the Revenue Act of 1926, *infra*, both of which sections provide that "A stock dividend shall not

be subject to tax." If the distributions here in issue were stock dividends within the meaning of the statute, the Commissioner's apportionment and allocation of the cost of the petitioner's preferred stock to the common stock received by the petitioner as dividends thereon was correct and the decision of the court below should be affirmed.

Prior to the Revenue Act of 1921, a tax was levied upon all "dividends." Cf. Revenue Act of 1916, Section 2 (a); Revenue Act of 1918, Section 213 (a). Following the decision of this Court in *Eisner* v. *Macomber,* 252 U. S. 189, where it was held that a stock dividend of common stock distributed *pro rata* to common stockholders did not constitute income within the meaning of the Sixteenth Amendment and could not be constitutionally taxed as such at the time of distribution, Congress in enacting the Revenue Act of 1921 expressly provided by Section 201 (d) of the Act that "A stock dividend shall not be subject to tax."[2] The exemption of stock dividends from taxation has been reenacted in all the subsequent Revenue Acts.[3]

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[2] H. Rep. No. 350, 67th Cong., 1st Sess. p. 8: "Section 202 modifies the definition of dividends in existing law by exempting stock dividends from the income tax, as required by the decision of the Supreme Court in *Eisner* v. *Macomber* 252 U. S., 189)." Similar language is contained in S. Rep. No. 275, 67th Cong., 1st Sess. p. 9.

[3] 201 (a) (f), Revenue Act of 1924.
201 (a) (f), Revenue Act of 1926.
115 (a) (f), Revenue Act of 1928.
115 (a) (f), Revenue Act of 1932.
115 (a) (f), Revenue Act of 1934.

The statute (Section 201 (f), *infra,* and Section 115 (f), *infra*), in declaring that a *stock dividend* shall not be subject to tax, does not undertake to define the term. The words of the statute, however, are broad and clear and should be given their plain and generally accepted meaning—that all stock dividends are not subject to tax. There is no qualification contained in the statute and its application can not be restricted, by construction, to the limited class of stock dividends which, under the decision of *Eisner* v. *Macomber, supra,* are constitutionally immune from income tax. It is well settled that when the language of a statute is clear and unambiguous, there is no room for interpretation, *The Cherokee Tobacco,* 11 Wall. 616; *Yerke* v. *United States,* 173 U. S. 439; *Ruggles* v. *Illinois,* 108 U. S. 526, 534; *Reinecke* v. *Smith,* 289 U. S. 172, 174, and the courts "are not at liberty to construe language so plain as to need no construction." *Helvering* v. *City Bank Co.,* 296 U. S. 85, 89.

Moreover, Congress did not limit the exemption from taxation to any particular type or class of stock dividend, or to such a dividend as is constitutionally immune to tax as income; and to do so by construction would, in effect, read into the statute a qualification not therein contained and amend the statute under the pretense of construing it. *Heiner* v. *Donnan,* 285 U. S. 312, 331. In *United States* v. *Goldenberg,* 168 U. S. 95, the Court said (pp. 102–103):

> The primary and general rule of statutory construction is that the intent of the lawmaker is to be found in the language that he has used. He is presumed to know the meaning of words and the rules of grammar. The courts have no function of legislation, and simply seek to ascertain the will of the legislator. It is true there are cases in which the letter of the statute is not deemed controlling, but the cases are few and exceptional, and only arise when there are cogent reasons for believing that the letter does not fully and accurately disclose the intent. No mere omission, no mere failure to provide for contingencies, which it may seem wise to have specifically provided for, justify any judicial addition to the language of the statute.

We submit that the phrase "stock dividends", when given its generally accepted meaning, connotes any dividend paid by a corporation by a distribution to its stockholders of its own new or theretofore unissued stock. The phrase is not limited in meaning only to such a distribution which preserves without change the stockholders' proportionate interest in the corporation or to one which is made in stock of a class similar to that already held by the stockholder. Thompson on Corporations, 3d Ed., Vol. 7, p. 137, Sec. 5263, states: "A stock dividend is what the term itself implies, a distribution of the stock of the corporation among the stockholders as a dividend." Paul

& Mertens, Law of Federal Income Taxation, Vol. 1, Sec. 8.74, defines the phrase as follows:

> Broadly defined, a stock dividend is a distribution of stock certificates of the distributing corporation representing a capitalization of all or part of the undivided profits * * * of the corporation.

In *Equitable Trust Co.* v. *Prentice,* 250 N. Y. 1, the court said (p. 12):

> Stock dividends in the true sense, *i. e.,* dividends capitalizing surplus as distinguished from those payable in the stock of a subsidiary (*People ex rel. Clark* v. *Gilchrist,* 243 N. Y. 173, 178; *U. S.* v. *Phellis,* 257 U. S. 156), have predominantly the quality of an increment to principal, though at times, in furtherance of intention, they have been classified as income. When a dividend is paid in cash, the ownership of the corporate assets is changed; the company owns less, and the shareholder owns more, or something essentially different, though its value be no greater. Upon the distribution of a stock dividend; ownership of the assets is precisely as it was. "A stock dividend does not distribute property, but simply dilutes the shares as they existed before" (*Williams* v. *W. U. Tel. Co.,* 93 N. Y. 162, 189). Whatever gain results to the shareholder from the division of his certificates is indirect and incidental, not extracted from the assets like the recurrent yield of an investment * * *.

In *Whetsel* v. *Forgey,* 323 Mo. 681, 693, a stock dividend was defined as "a dividend paid in stock instead of cash." *Cf. Lamb* v. *Lehmann,* 110 O. S. 59, 78. For further definitions of a stock dividend see *Kaufman* v. *Charlottesville Woolen Mills,* 93 Va. 673, 675–6; *Graves* v. *Graves,* 94 N. J. Eq. 268, 276.

In the instant case common stock was distributed as a dividend on preferred stock, but the fact that the stock distributed as a dividend was not of the same class as that held by the petitioner does not serve to make the distribution of its own stock by the corporation any the less a *stock dividend.* Neither the clear language of the statute nor the meaning of the phrase requires that the stock held and the stock distributed be of the same class.

If there should be any real doubt whether the phrase "stock dividend" embraces generally all dividends paid by a corporation in its new or unissued stock, as distinguished from other forms of property, we submit that such doubt is resolved by the administrative construction of the provision.

Following the decision of *Eisner* v. *Macomber, supra,* T. D. 3052, 3 Cumulative Bulletin 38 (July–December, 1920), was promulgated, which contained among other provisions the following (p. 38):

> 1. Where a corporation, being authorized so to do by the laws of the State in which it is incorporated, transfers a portion of its surplus to capital account, issues new stock

representing the amount of the surplus so transferred, and distributes the stock so issued to its stockholders, such stock is not income to the stockholders, and the stockholders incur no liability for income tax by reason of its receipt.

Moreover, by T. D. 3059, 3 Cumulative Bulletin 38–39, Article 1545 of Regulations 45, which held that a dividend paid in stock of the corporation was income, was revoked, and Article 1547 of Regulations 45, which was to the effect that stock dividends were taxable income under the Revenue Act of 1916, was amended to read in part as follows (p. 39):

> ART. 1547. *Sale of stock received as dividend.—Stock received as a dividend does not constitute taxable income to the stockholder,* but any profit derived by the stockholder from the sale of such stock is taxable income to him. For the purpose of ascertaining the gain or loss derived from the sale of such stock, or from the sale of the stock with respect to which it is issued, the cost (used to include also, where required, the fair market value as of March 1, 1913) of both the old and new shares is to be determined in accordance with the following rules:
>
> (1) Where the stock issued as a dividend is all of substantially the same character or preference as the stock upon which the stock dividend is paid, the cost of each share of both the old and new stock will be the quo-

tient of the cost, or fair market value as of March 1, 1913, if acquired prior to that date, of the old shares of stock divided by the total number of the old and new shares.

(2) *Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the stock dividend is paid,* the cost, or fair market value as of March 1, 1913, if acquired prior to that date, of the old shares of stock shall be divided between such old stock and the new stock, or classes of new stock, in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the cost of each share of stock will be the quotient of the cost of the class to which such share belongs divided by the number of shares in that class. (Italics supplied.)

This Treasury Decision was incorporated in Article 1548, Regulations 62, under the Revenue Act of 1921, and subsequent Regulations contain substantially similar provisions.[4]

The Commissioner has consistently provided in Regulations issued since the Revenue Act of 1921 that the phrase "stock dividend" within the meaning of the exemption includes the issuance of its own stock by a corporation to its shareholders.

[4] Articles 1547 and 1548, Regulations 65, 1924 Act; Articles 1547 and 1548, Regulations 69, 1926 Act; Articles 627 and 628, Regulations 74, 1928 Act; Articles 627 and 628, Regulations 77, 1932 Act; Articles 115–7 and 115–8, Regulations 86, 1934 Act.

Articles 1547 and 1548, Regulations 69; Articles 1547 and 1548, Regulations 62 and 65; Articles 627 and 628, Regulations 74 and 77; Articles 115–7 and 115–8, Regulations 86.

The Income Tax Unit has specifically ruled that common stock paid as a dividend on preferred shares is nontaxable. I. T. 2538, IX–1 Cumulative Bulletin 144. *Cf.* T. D. 3059, 3 Cumulative Bulletin 38–39, (2) *supra;* Article 600 (2) of Regulations 74, *infra.*

We do not think that the statute is ambiguous, but, if we err in this respect, we submit that the consistent administrative interpretation of the statute is entitled to great weight and should resolve the doubt, since it is neither unreasonable nor inconsistent with the statute. This Court has repeatedly held that great weight must be accorded continued administrative application and construction of statutory provisions. *National Lead Co.* v. *United States,* 252 U. S. 140, 144–145. Furthermore, the reenactment of the statute without change is persuasive evidence of legislative approval of the administrative interpretation of the statute. *Morrissey* v. *Helvering,* 296 U. S. 344. This legislative approval of the administrative construction requires a conclusion that the regulations are correct, consistent with the legislative intent, and not repugnant to the statute.

The petitioner refers to the Committee Reports [5] on the Revenue Act of 1921 as furnishing support for the argument that the statute exempts from taxation only such "stock dividends" as are constitutionally immune from taxation under *Eisner* v. *Macomber, supra.* It is no doubt true that the decision in that case, holding that stock dividends which do not constitute *income* within the meaning of the Sixteenth Amendment cannot be constitutionally taxed as such, was the underlying reason for the enactment of Section 201 (d) of the Revenue Act of 1921. However, the unambiguous language of the provision "a stock dividend shall not be subject to tax", warrants the conclusion that Congress intended to exempt all stock dividends from tax, and by so doing to avoid perhaps the levying of a tax which, in all probability, would result in controversy as to its constitutionality. This conclusion finds support in the fact that Congress placed no limitation or classification on the nature or type of stock dividend exempted from tax and used language which is so plain in meaning as not to justify resort to Committee Reports for ascertainment of intention. *Helvering* v. *City Bank Co., supra.*

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[5] H. Rep. No. 350, 67th Cong., 1st Sess., p. 8: "Section 202 modifies the definition of dividends in existing law by exempting stock dividends from the income tax, as required by the decision of the Supreme Court in *Eisner* v. *Macomber* (252 U. S. 189)". Similar language is contained in S. Rep. No. 275, 67th Cong., 1st Sess., p. 9.

Moreover, after the decision of this Court in *Eisner* v. *Macomber, supra,* holding that Congress could not constitutionally levy an income tax on a dividend paid in common stock to common stockholders, it was not necessary for Congress to expressly exempt from taxation that which it could not constitutionally tax, and we cannot assume that this was the sole Congressional purpose. The exemption must have been intended to embrace all stock dividends capitalizing surplus of whatever type or class and to remove any doubt as to the taxability of stock dividends other than those of the class involved in *Eisner* v. *Mcomber, supra.* Administrative interpretation and legislative approval of that interpretation support the conclusion.

Moreover, Section 115 (a) of the Revenue Act of 1928, *infra,* which is substantially the same as Section 201 (a) of the Revenue Acts of 1924 and 1926 and Section 201 (a) of the Revenue Act of 1921, defines a "dividend" as "any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913." The definition embraces two classes of dividends, (1) "in money" and (2) "in other property;" but there must be a *"distribution"* (a severance of assets from the corporation) made by the corporation of one or the other, and that from earnings or profits accumulated after February 28, 1913. The

statute does not further define a "dividend", and we submit that it is a fair inference that Congress intended to tax only such dividends as came within its definition of the word "dividend" as used in the Act. In the instant case the corporation made no "distribution * * * out of earnings or profits." To the contrary, the corporation capitalized its earnings and profits to the extent of the stock dividend and rendered them unavailable for the purpose of distribution to stockholders. It follows that the stock dividend here involved does not meet the requirements of Section 115 (a), *infra,* is not taxable as a dividend thereunder, and hence it falls, as Congress intended it to, within the exemption of Section 115 (f), *infra.*

In *Commissioner* v. *Tillotson Mfg. Co.,* 76 F. (2d) 189, the Circuit Court of Appeals for the Sixth Circuit held that dividends on preferred stock paid in common stock were subject to tax, since they constituted income to the recipient. In that case the court pointed out that this Court, in *Eisner* v. *Macomber, supra,* in considering a stock dividend, established two tests for determining whether the stock dividend was taxable or nontaxable. The tests stated by the court were (p. 190): (1) severance of assets from the corporation, and (2) alteration of the preexisting proportionate interest of the stockholders. In the *Tillotson* case the court applied those tests to the stock dividend there involved, and was of opinion that, since the

dividend was paid to preferred stockholders in common stock, and because of inherent differences in the two kinds of stock, the second test was not met and hence the stock dividend could not be deemed a nontaxable stock dividend, as defined in *Eisner* v. *Macomber, supra.* We think that the court in the *Tillotson* case erred in basing its decision solely on tests which had for their purpose the ascertainment of whether a stockholder had received *income* as a result of a stock dividend. The decision, in substance, turns on the fact that, under *Eisner* v. *Macomber, supra,* the stock dividend would have been taxable. The statute exempting stock dividends from tax, as we have said, is not limited to the type of stock dividends involved in the *Macomber* case; and, if this be true, then we submit that the court in the *Tillotson* case should have determined the taxability of the stock dividend under the statute and not by resort to tests of income realization from stock dividends under a Revenue Act which expressly taxed "dividends."

While in the *Macomber* case the stock was all of the one class,—common stock,—it should be noted that the Court in considering the essential character of a stock dividend emphasized the fact that the aggregate assets of the corporation are not affected and the stockholder thereby receives none of the corporate assets. After discussing the relation of the stockholder to the corporation and the necessities of corporate activities requiring the use

of surplus profits in the business, instead of distributing the same as dividends, in which event the amount of profits retained are charged to surplus, credited to capital stock and stock for that amount issued pro rata to the stockholders, the Court said (p. 211):

> A "stock dividend" shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.
>
> The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment.

Whether or not the issuance of the common stock to the petitioner as a dividend on her preferred stock altered the proportionate interest she held in the corporation and its assets, the fact remains that there was no severance of the corporation's assets and the petitioner thereby received none of the corporate assets. The accumulated earnings of the corporation were not distributed, but on the contrary were retained in the business. There has been only an increase of the evidences of her investment; true to some extent different in form, yet her entire original investment, together with the accretions thereto, remain in the corporation with that of other stockholders subject to the risks of the business which might wipe out the entire investment. We submit that the common stock received by the petitioner as a dividend on preferred stock may properly be treated as a stock dividend, under the *Macomber* case. Both the common stock and the preferred stock represented her investment and a portion of the cost of the latter must be allocated to the common stock.

The reasoning of the dissenting opinion in this case (R. 117–118), upon which the petitioner relies (Pet. 7), that the "majority opinion's interpretation would have Congress attempting to tax *CAPITAL* by the device of deducting from capital cost *INCOME* produced from capital in determining the gain on the sale of the stock representing the original investment," is unsound for the reason that it presupposes the stock dividend in its

entirety to be capital. That is no more the case than increase in value between the time of purchase and sale of stock is *capital* to the owner of stock. *Miles* v. *Safe Deposit Co., supra* (p. 252); *Eisner* v. *Macomber, supra* (pp. 214–215). *Merchants' L. & T. Co.* v. *Smietanka,* 255 U. S. 509, 510. In neither case has there been an actual realization of gain by a severance of assets from the corporation.

Peabody v. *Eisner,* 247 U. S. 347; *United States* v. *Phellis,* 257 U. S. 156; and *Marr* v. *United States,* 268 U. S. 536, are not determinative of the question here presented. In those cases it was held that dividends paid by a corporation to its stockholders in stock of another corporation, or in the stock of a corporation not substantially identical with the distributing corporation, were taxable as dividends for the reason that the stockholder received either a part of the distributing corporation's assets or a new and entirely different interest from that formerly held. In each of the cited cases there was a severance of assets from the corporation. Such a distribution is not a stock dividend but a property dividend and the cases have no application here. *Eisner* v. *Macomber, supra* (p. 215); *Peabody* v. *Eisner, supra* (pp. 349–350). The stock of the new corporation, which was distributed by the old corporation to its stockholders, in *Weiss* v. *Stearn,* 265 U. S. 242, was held in that case to be a nontaxable dividend for the reason that, because of the substantial

identity of the two corporations, the stockholder's interest remained the same after the distribution as it was before. That case presented the question whether a pure stock dividend differing in form from that involved in *Eisner* v. *Macomber, supra,* but essentially similar to it because of substantial corporate identities could be constitutionally taxed. Applying the principles of *Eisner* v. *Macomber, supra,* the Court held that it could not. We think that *Weiss* v. *Stearn, supra,* like *Eisner* v. *Macomber, supra,* is distinguishable. If it should be considered that under these cases a stock dividend is essentially one which does alter the stockholder's proportionate interes in the corporation, nevertheless the dividend here is a stock dividend for the purpose of the statute and exempted by it from taxation, regardless of whether under those cases it could have constituted income to the petitioner and might have been constitutionally taxed to her as such. The question here is not what Congress may tax but what has Congress exempted from tax.

It is a matter of conjecture whether the Commissioner's interpretation of Section 115 (f) will operate generally to the advantage of the Treasury or of the taxpayer. In the instant case it is the Treasury which benefits. However, if the Commissioner's interpretation is erroneous, taxpayers similarly situated would be taxable for surtax pur-

poses at the time when the stock dividend is received; whereas under the Commissioner's interpretation the tax would be postponed until sale or other disposition when, because of fluctuation in value, no taxable income might result.

In view of the plain terms of the statute and its long continued administrative interpretation, we submit that the stock dividend here in issue and similar distributions, as the court below held, were exempt from tax at the time when made.

II

IF THE STOCK DIVIDENDS WERE EXEMPT FROM TAX WHEN RECEIVED THE COMMISSIONER PROPERLY APPORTIONED COST UNDER VALID REGULATIONS

The petitioner urges (Br. 26–34) that even if we are correct in the contention that the common stock dividend in this case was exempt from tax by the statute, it was nevertheless improper for the Commissioner by his regulations to allocate the cost of the preferred stock originally purchased between both the original preferred and the common stock received as dividends, in the absence of express statutory authority. The regulations referred to are Articles 58, 628, and 600 of Regulations 74, *infra*. This contention is without merit.

The fact that there is no express statutory authority to issue regulations upon a given statutory provision clearly would not render invalid a regulation in respect thereto. The conclusion that such is the case would render meaningless the broad

power given the Commissioner under the Revenue Acts to issue regulations needful for the enforcement of the Act. Cf. Regulations 74, Article 62. Numerous instances may be cited of regulations issued and approved upon a given subject in which there was no specific statutory authority or command.

For example, in the absence of express statutory provision under Section 22 of the Revenue Act of 1928, the Commissioner promulgated the so-called "first-in, first-out" rule in the first two sentences of Article 58 of Regulations 74. That provision of the regulations has been upheld as valid. *Helvering* v. *Rankin,* 295 U. S. 123; *Snyder* v. *Commissioner,* 295 U. S. 134, 141. Where a statute provided that the basis of property acquired by bequest, devise, or inheritance should be the fair market price at the time of acquisition, this Court approved the Commissioner's regulations providing that the value at the time of the death of the decedent should be taken as the basis for ascertaining gain from the sale of property acquired by bequest or descent. *Brewster* v. *Gage,* 280 U. S. 327. And in *Hartley* v. *Commissioner,* 295 U. S. 216, this Court approved regulations providing that the basis in the hands of the decedent's estate should be the value at the date of the decedent's death rather than cost to the decedent, where the statute had only provided cost as the basis. In *Fawcus Machine Co.* v. *United States,* 282 U. S. 375, this Court, in an invested capital case, ap-

proved the Commissioner's regulation with respect to the treatment of taxes levied against the taxpayer, in the absence of any express statutory authority to issue a ruling upon the subject.

A situation not unlike that disclosed here exists in cases of an exchange in a corporate reorganization of one class of old stock for two classes of new stock. In the case of reorganization, no gain or loss being recognized on the exchange of stock, the cost of the old stock is substituted as the cost of the new. Cf. Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 202 (c) (2) and (d) (1). The statute in such case did not provide for an apportionment of the cost of the old stock over the respective classes of the new stock. But the regulations did so provide (cf. Regulations 62, Art. 1567), and they have been approved as a correct exposition of the legislative intent (*Houghton* v. *Commissioner,* 71 F. (2d) 656 (C. C. A. 2d), certiorari denied, 293 U. S. 608; *Curtiss* v. *Commissioner,* 57 F. (2d) 847 (C. C. A. 5th). Cf., also, *Taylor* v. *Commissioner,* 70 F. (2d) 619 (C. C. A. 2d); *Helvering* v. *Taylor,* 293 U. S. 507).

Moreover, in *Miles* v. *Safe Deposit Co.,* 259 U. S. 247, this Court, after characterizing a stockholder's right to subscribe to the corporation's new stock by saying that such right was essentially analogous to a stock dividend, held that a portion of the cost of the stockholder's original stock should be allocated to the right, as was provided for in the case of stock dividends under Article 1547 (1) of Regulations 45, promulgated under

Section 201 of the Revenue Act of 1918, which did not expressly authorize the Commissioner to apportion or allocate cost in such a case.

The regulation attacked by the petitioner was necessary to carry out the provisions of the Act. The Act provided that a stock dividend shall not be subject to tax. In view of this provision it was necessary in the administration of the Revenue Act to determine the amount of gain taxable upon a later sale of the stock upon which the dividend was declared as well as the dividend stock. This is a plain case in which regulations were needful. Furthermore, they truly interpret the provisions of the Act and are not inconsistent therewith.

Congress in exempting all stock dividends from tax saw fit to treat a stock dividend of whatever kind as merely additional evidence of a capital interest of the stockholder representing property allowed to remain with the corporation, the sum of all these evidences of interest representing his capital investment in the corporation. Such being the intent, it is clearly consistent therewith to spread the original cost of the stockholder's capital investment over his whole capital interest now existing in the corporation. Indeed, it is necessary to do this, for otherwise the basis would not be *the cost of the property sold,* which is the true statutory basis. See *United States* v. *Ludey,* 274 U. S. 295. The regulation does not have the effect of taxing the stockholder's capital, which is all

returned to him upon the sale of all the stock representing his retained capital interest.

A regulation not inconsistent with the statute and reasonably adapted to carry out the legislative intent is valid. *National Lead Co.* v. *United States, supra.* Adopting the test in *Manhattan General Equipment Co.* v. *Commissioner*, decided by this Court February 3, 1936 (rehearing denied, March 2, 1936), cited by petitioner (Br. 29), we submit that the regulation is consistent with the statute exempting a stock dividend from taxation and is reasonable. It constitutes a fair attempt to carry into effect the legislative intent and violates no provision of the statute. *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 414.

Congress, no doubt, could have expressly provided in the statute, that in a case of the type here involved, a portion of the cost of the original stock should be allocated to the stock distributed as a dividend, but its failure to do so specifically does not, of itself, render the regulations so providing invalid. *LaMotte* v. *United States,* 254 U. S. 570, 576. Congress, in broadly authorizing the Commissioner to prescribe regulations needful for the enforcement of the Revenue Acts, did so because of a realization that a Revenue Act was not, in itself or its separate provisions, complete and that regulations were necessary to bridge the gaps left by the letter of the law and to minimize inequalities. *United States* v. *Grimaud,* 220 U. S.

506, 517. For this reason, we submit, it was unnecessary to the validity of the regulations here involved that Congress expressly provide, by Section 115 (a) (f), *infra,* that the Commissioner was authorized to prescribe regulations allocating a portion of the cost of old stock to the dividend stock, in the case of a stock dividend, or that such allocation should be made under regulations prescribed by the Commissioner. *Heiner* v. *Tindle,* 276 U. S. 582.

If, as the petitioner concedes (Br. 32), it is proper to allocate the original cost of common stock over new common stock received as a dividend, rather than to assign the whole cost to the shares originally purchased, it is equally proper to allocate the cost in the case of shares of a different character where the distribution is tax-exempt.

The regulation providing for the allocation of cost over the old and the new dividend stock has been in effect under numerous Revenue Acts (see pages 13–16, *supra*), and the reenactment of the revenue laws without change evidences legislative approval (*Brewster* v. *Gage, supra; Morrissey* v. *Helvering, supra*). If this were contrary to the legislative intent it is reasonable to suppose that the practice would have been corrected in some of the revisions of the revenue laws. *Heiner* v. *Colonial Trust Co.,* 275 U. S. 232.

III

THE PETITIONER IS ESTOPPED TO DENY THE COMMON STOCK RECEIVED AS A DIVIDEND ON PREFERRED STOCK WAS A STOCK DIVIDEND

If the Court should be of the opinion that the common stocks received as dividends on petitioner's preferred stock were not in fact stock dividends and nontaxable, then under the circumstances of this case we submit the petitioner is estopped to assert the fact to avoid the tax upon the direct gain resulting from the disposition of the preferred stock in a later year. If the common stocks were not received as stock dividends within the meaning of the statute, they were property dividends and taxable income in the years in which they were received and the statute required that the petitioner report such income on her tax returns. Sections 201 (a) (b), 213 (a), Revenue Act of 1926, c. 27, 44 Stat. 9. The petitioner, however, did not include in her returns for the years 1925–1928, inclusive, any taxable income on account of the common stocks received as dividends during those years. (R. 59.) The petitioner's tax returns, as made by her from 1925 to 1928, inclusive, were accepted by the Commissioner in this respect and by failing to report thereon the dividends and common stock, the petitioner represented that no taxable dividends on her preferred stock had been received in those years. She should not now be heard to say that the dividends and

common stock were taxable dividends in the years of receipt and not nontaxable stock dividends, as she impliedly represented. When the result of such change of position is to defeat the proper apportionment of her preferred stock costs, and the tax upon the gain realized by her on the redemption of her preferred stock in 1930, a party cannot, having represented one state of facts to exist and led others to rely thereon, deny the fact and assume an inconsistent position. See *Casey* v. *Galli,* 94 U. S. 673, 680; *Morgan* v. *Railroad Co.,* 96 U. S. 716, 720; *Central Pacific Railroad* v. *California,* 162 U. S. 91, 113–114.

The petitioner now, after the statute of limitations has run, attempts to reverse the position taken by her in the years when she received the common stock as stock dividends. The existence of these elements is all that is required to establish equitable estoppel. *Stone* v. *Bank of Commerce,* 174 U. S. 412; *Kirk* v. *Hamilton,* 102 U. S. 68; *Dickerson* v. *Colgrove,* 100 U. S. 578; *Oklahoma* v. *Texas,* 268 U. S. 252.

The principle that a litigant may not found his claim on his own inequity or wrong is forcibly enunciated by this Court in the case of *Stearns Co.* v. *United States,* 291 U. S. 54. In that case the Court said (pp. 61–62):

> The applicable principle is fundamental and unquestioned. "He who prevents a thing from being done may not avail himself of the non-performance which he has himself

> occasioned, for the law says to him in effect 'this is your own act, and therefore you are not damnified.'" * * * Sometimes the resulting disability has been characterized as an estoppel, sometimes as a waiver. The label counts for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be permitted to found any claim upon his own inequity or take advantage of his own wrong. * * * A suit may not be built on an omission induced by him who sues.

In *Bothwell* v. *Commissioner,* 77 F. (2d) 35 (C. C. A. 10th), the taxpayers in 1927 purchased stock of a corporation, of which they were officers, for a price far below its fair market value. In 1928 they sold such stock and contended that the profit on the sale was the difference between the fair market value of the stock on the date they acquired it in 1927 and the selling price in 1928. They claimed that the difference between the price at which they purchased it and its fair market value was compensation for personal services rendered the corporation, but they had not reported such difference in their income tax returns for the year 1927, and at the time they first made such contention the statute of limitations had expired for that year. In holding that they were estopped to claim the fair market value in 1927 as the basis for measuring the profit on the sale, the court said (p. 37):

> By failing to report such income, each in effect declared that no such income had been received by him. *Crane* v. *Commissioner* (C. C. A. 1) 68 F. (2d) 640, 641. Furthermore, up to the time the amended petitions were filed, each had asserted that the income received by him was capital gain rather than compensation for services. At the time the amended petitions were filed the statute of limitation had run as to the 1927 taxes.
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> * * * * *
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> Darby and Bothwell each having declared in 1927 that no part of the value of the stock was compensation for services, and having continuously asserted from 1928 until after the statute of limitation had run against taxes for 1927, that the whole of the profit derived from the sale of such stock was capital gain, they are now precluded from asserting that a portion of the value of such stock was compensation for services. They are barred from so doing by their wrongful acts and omissions.

In *Larkin* v. *United States,* 78 F. (2d) 951 (C. C. A. 8th) the taxpayers who had purchased from their employer at $100 per share stock having a fair market value of $250 per share subsequently on the sale of that stock, attempted to show a loss by basing the cost on the market value. The court held that the failure of the taxpayers to report the difference in their income tax returns for the year in which the stock was purchased estopped them from maintaining the suit.

In *Askin & Marine Co.* v. *Commissioner,* 66 F. (2d) 776 (C. C. A. 2d), the taxpayer, conceding that a deduction for bad debts in 1920 was properly disallowed by the Commissioner because the debts were not ascertained to be worthless in that year, contended that the collections in 1920 of amounts similarly charged off in earlier years and allowed as deductions, although not ascertained to be worthless in the year of charge-off, could not be included in its income for 1920. The court, denying the contention, said (p. 778):

> Having represented that it had ascertained these accounts charged off its active file to be worthless and having received the benefit of the deduction it claimed when the commissioner took its representation of the ascertainment of worthlessness at its face value, we think the petitioner is now clearly estopped from denying, to the prejudice of the government, the truth of the representations upon which it has succeeded in former years in obtaining deductions from its gross income. While the commissioner must investigate returns to satisfy himself of their correctness in fact and law, a taxpayer may not benefit at the expense of the government by misrepresenting facts under oath; by succeeding in having the commissioner accept its representations as the truth; and by claiming later that what it represented to be true might have been found false had the commissioner refused to have faith in the sworn return. * * *

In *Hartwell Mills* v. *Rose,* 61 F. (2d) 441 (C. C. A. 5th), it was held that the taxpayer could not contend that certain assessments were void. The court said that taxation is a practical matter having to do with matters which ought to be, and normally are, disposed of informally; that where rights have been substantially preserved, proceedings will not be defeated by defects in form. The court then said (p. 444):

> Especially is it true that, where the government and the taxpayer, by acquiescence in the manner of performing an act, have given a definite character and effect to it, the taxpayer will not be permitted, after deriving benefits from this acquiescence, to deny this character and effect to it, or to change his position at the government's expense.

In *Helvering* v. *Salvage,* decided by this Court January 13, 1936, the question of estoppel had not been raised before the Board and should not have been considered by the Circuit Court of Appeals. *General Utilities Co.* v. *Helvering,* 296 U. S. 200. The Court in the *Salvage* case said of the estoppel question in that case: "Furthermore, the facts disclosed give it no support." That is not the situation in the instant case. Here the issue of estoppel was raised before the Board by the Commissioner's answer (R. 24), and decided against the Commissioner by the Board (Memorandum Opinion, R. 31). The holding of the Board of Tax Appeals in the instant case on the question of estoppel was assigned by the Commissioner as error in his peti-

tion for review filed with the Circuit Court of Appeals. (Petition for Review, Par. 14, 15, R. 38.) We submit that the facts presented on the record of this case furnish support to the contention.

The petitioner having omitted on her returns any amount for the common stock as taxable dividends in the years of receipt represented that they were not taxable dividends but were stock dividends. Those returns were accepted by the Commissioner. The petitioner should not now be heard to say that the shares of common stock were taxable dividends when received and not stock dividends which proportionately reduced the cost of the preferred stock in respect of which they were issued, so that the taxable gain on the later disposition of the preferred must be measured by the original cost without regard to the common stock received free from tax. See *Askin & Marine Co.* v. *Commissioner, supra.*

The Circuit Court of Appeals in deciding the instant case did not pass on the question of estoppel and we submit that, if the Court is of opinion that the stock dividends here involved were not nontaxable stock dividends, the Court should hold that the petitioner is estopped to assert that fact in these proceedings, or remand this case to the Circuit Court of Appeals with directions to that court to pass on the question.

CONCLUSION

The decision of the Circuit Court of Appeals is correct and should be affirmed. In the event that the Court be of opinion that the Circuit Court of Appeals erred in holding the stock dividend share involved to be nontaxable, then we submit that the Court should hold the petitioner is estopped to contend in these proceedings that the stock dividends were taxable, or remand this case to the Circuit Court of Appeals with directions that it pass on the question.

Respectfully submitted.

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APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791, 822, 842:

> SEC. 115. DISTRIBUTIONS BY CORPORATIONS.
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> (a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.
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> * * * * *
>
> (f) *Stock dividend.*—A stock dividend shall not be subject to tax.
>
> * * * * *

Section 201 (a) (f), Revenue Act of 1926, c. 27, 44 Stat. 9, and, so far as material here, Section 201 (a) (f), Revenue Act of 1924, c. 234, 43 Stat. 253, are substantially the same as the Section above quoted.

Treasury Regulations 74:

> ART. 58. *Sale of stock and rights.*—* * * In the case of stock in respect of which any stock dividend was paid, the basis for determining gain or loss from a sale of a share of such stock shall be ascertained in accordance with the principles laid down in article 600. Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be

impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost.

ART. 600. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 112 (g) and article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization is all of substantially the same character or preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock

are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class.

(3) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and at different prices, and the identity of the lots cannot be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see article 58), and any sale of the stock distributed in reorganization will be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

(4) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and at different prices, and the stock distributed in reorganization cannot be identified as having been distributed in respect of any particular lot of such stock, then any sale of the stock distributed in reorganization will be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

ART. 628. *Stock dividends.*—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600.

The provisions of Treasury Regulations 65, promulgated under the Revenue Act of 1924, and Treasury Regulations 69, promulgated under the Revenue Act of 1926 (Articles 39, 1548, and 1599), so far as material, are substantially the same as the above-quoted provisions of Treasury Regulations 74.

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